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**CONSTRUCTING  
ACCOUNTS FROM  
DEFICIENT RECORDS**

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## PREFACE

THE task of constructing accounts from deficient records is one upon which the professional accountant is frequently engaged and no branch of professional work makes larger demands upon his experience, care and skill. The substance of this book was originally delivered as a lecture to the Incorporated Accountants' Course at Caius and Gonville College, Cambridge; its purpose is to consider the technical problems arising and to suggest and illustrate methods of approach which have been found useful in practice.

In some of its phases this work requires a good deal of knowledge of the ways of men and of insight into their minds; this kind of knowledge cannot be given in books but is garnered by the alert mind using open eyes upon the varied experiences of life. One of the lessons of experience is that in each investigation an open mind should be retained as long as possible; in no sphere is jumping to conclusions more dangerous.

The author gladly acknowledges his debt to the members of the "Cambridge Course, 1936"; to the ever ready help and wide experience of his partner, Mr. W. H. Morgan, F.S.A.A.; and to his friend Mr. Donald Hayden, F.S.A.A., for valued assistance on matters of which he has a specialist's knowledge.

W. J. B.



# CONTENTS

CHAP.	PAGE
PREFACE . . . . .	V
I. INTRODUCTORY . . . . .	I
II. THE LEGAL POSITION:	
(a) IN RELATION TO THE KEEPING OF ACCOUNTS . . . . .	5
(b) IN RELATION TO THE ACCOUNTANT'S RESPONSIBILITY . . . . .	II
III. OUTLINE OF GENERAL PROCEDURE . . . . .	15
IV. CERTAIN MATTERS REQUIRING SPECIAL ATTENTION . . . . .	33
V. PRACTICAL ILLUSTRATIONS:	
(a) SMALL ENGINEERING SHOP . . . . .	42
(b) TAILOR . . . . .	47
(c) RETAIL SHOPKEEPER . . . . .	49
(d) BUILDER AND CONTRACTOR . . . . .	50
(e) SOLICITOR . . . . .	52
(f) FARMER . . . . .	56
(g) BACK DUTY INVESTIGATION . . . . .	60
VI. REPORTS TO CLIENTS . . . . .	64
VII. ON COMPLETING ACCOUNTS FOR THE FUTURE . . . . .	68
APPENDIX—FORMS AND EXAMPLES . . . . .	73
INDEX . . . . .	83





# CONSTRUCTING ACCOUNTS FROM DEFICIENT RECORDS

## CHAPTER I INTRODUCTORY

### I

NOTWITHSTANDING the increase in commercial education, there are still very many small businesses in which the records currently maintained are not sufficient to disclose all the business transactions and financial position; the task of preparing accounts in such cases may be simple but it may also be among the most difficult and responsible undertaken by professional accountants, especially where the trade is entirely or mainly for cash. Many practices consist largely of work for small concerns and, in spite of the growth of large manufacturing units, distributing organizations and chain stores, a great proportion of business transactions remains in the hands of individually small traders.

In addition to traders, many professional people, such as doctors, dentists and solicitors, have insufficient work to employ a full-time book-keeper; they may engage part-time clerical assistance but are frequently content to make such records themselves as will enable charges to be made against their clients, and from these minimum records some kind of estimation of profits is made annually for

the purpose of an income tax return. Very frequently this annual work is in the hands of professional accountants.

The subject is, therefore, of great importance to many accountants and as the possibilities of variety in incompleteness are infinite, the resultant complexity calls for more detailed consideration than has usually been given to it.

## 2

Technically, the book-keeping of a business is "deficient" unless the books contain a complete record (a) of cash received and paid; (b) of trading transactions; and also are regularly written up and balanced so that it is possible at any time to discover the state of the trader's affairs and the result of his trading since the last balancing date. It is not, however, usual to describe the book-keeping as incomplete in cases where the records of cash and transactions are duly and promptly made but the impersonal side of the posting is left for the professional accountant to deal with by writing up a Private Ledger; in such cases his work as accountant is regarded as included in the book-keeping of the concern and when he has done it, the records are complete.

It is comparatively easy for an accountant to deal with matters recorded in any way in the books of account and to complete the partial record, making such corrections therein as may be necessary. It has been said, on high authority, of the auditor that he "is not bound to be a detective," that "he is a watch-dog but not a bloodhound"; a completer of partial and incomplete records,

however, is not acting in the capacity of auditor and must possess some at least of the qualities of the bloodhound or of an ordinary detective, though he is not expected to rival the imaginative reconstructions of Sherlock Holmes. He must not be content with the pedestrian qualities of the mere watch-dog. Indeed, his task is largely that of discovering the things which are nowhere recorded and dealing adequately with them.

On the other hand, the accountant is not a diviner and if he manages sometimes to make bricks without straw, he is not able to make them without clay, and where the information is not available in some form or other, he is almost helpless. For example, a case was recently reported in which a shopkeeper was in negotiation for the sale of his business and the prospective purchaser instructed an accountant to investigate and prepare some statement of working. The shopkeeper produced a neat record of daily cash takings which, on the basis of the gross profit percentage he claimed to make, and which might be regarded as usual in his trade, would give a margin showing a reasonable living for the shopkeeper, but he explained that he had no record of his purchases; he had no bank account, his sales were for cash and he paid for his purchases out of the cash takings and kept the balance himself. In response to inquiry, he assured the accountant that he kept all invoices and receipts on a file, which he produced, but the summation of the invoices for the last year, with an adjustment for the assumed gross profit, gave no confirmation of the total said to be cash takings. In such a case it

is obviously beyond the power of the accountant to prepare satisfactory accounts. The materials are not available and, as far as the past working is concerned, the accountant will sometimes find himself in a position where he can only report such a conclusion to his client.

## CHAPTER II

### THE LEGAL POSITION

#### (a) IN RELATION TO THE KEEPING OF ACCOUNTS

##### **By a Sole Trader**

THERE is no statutory obligation on a private trader to keep book records of his trading transactions but (a) he is under obligation to make an annual return of his income for assessment to income tax and to satisfy the Inspector of Taxes, or the Commissioners, that it is correct, and (b) if he should be so unfortunate as to become subject to the provisions of bankruptcy legislation, certain other considerations will arise.

With regard to the first of these considerations it should be realized that there is a duty on every trader to make and deliver to the assessor of taxes "a true and correct statement" containing "the amount of the profits or gains arising to him" from his business, for the purpose of assessment to income tax and he cannot do this satisfactorily unless book records of his trading are properly kept and balanced from time to time.

Further, failing agreement with the Inspector of Taxes as to the amount of his assessable profits, the Inspector will make an assessment according to his estimate of the trader's profits, and either this will have to be accepted or an appeal made to the Commissioners. On appeal, the onus will lie upon the appellant to prove that the assessment is excessive, and the Commissioners may call for such information as they consider necessary to enable

them to determine the question ; this will be done by issuing a precept requiring the tax-payer to deliver within a specified time schedules of details in regard to the business and the profits. (Section 139, Income Tax Act, 1918.)

In the case of *Schulze v. Bensted* (1915), the tax-payer did not deliver the schedules of particulars in regard to his business and profits, which the Commissioners required, and they thereupon confirmed the assessment made on him. This decision was approved by the High Court.

In *Hawthornethwaite & Sons v. Kelly* the High Court held that the Commissioners were entitled to satisfaction as to what profits had been made and as this could not be obtained without the production of books and documents, they were entitled to call for these and, in the absence of their production, to confirm the assessments made.

It is obviously necessary, for the trader's protection, that he should keep accounts adequate for the purpose of demonstrating the result of his trading, and he should keep them in such a form that statements can be produced from time to time, properly vouched, which shall supply answers to the reasonable and proper inquiries of the taxation officials.

With regard to the second consideration named above, the provisions in relation to bankruptcy are—

Section 158, subsection 1, Bankruptcy Act, 1914, as amended by Section 7 of the Bankruptcy Amendment Act, 1926.

Any person who has been adjudged bankrupt, or in respect of whose estate a Receiving Order has been made, shall be guilty

of a misdemeanour if having engaged in any trade or business during any period in the two years immediately preceding the date of the presentation of the bankruptcy petition, he has not kept proper books of account throughout that period and throughout any further period in which he was so engaged between the date of the presentation of the petition and the date of the Receiving Order, or has not preserved all books of account so kept: provided that a person who has not kept or has not preserved such books of account shall not be convicted of an offence under this section—(a) if his unsecured liabilities at the date of the Receiving Order did not exceed, in the case of a person who has not on any previous occasion been adjudged bankrupt or made a composition or arrangement with his creditors, £500, or in any other case £100, or (b) if he proves that in the circumstances in which he traded or carried on business, the omission was honest and excusable.

Further, the Court cannot grant an unconditional discharge from bankruptcy where the bankrupt has committed any of the offences set out under Section 26 (3) of the Bankruptcy Act, 1914, which includes *inter alia*—

(b) that the bankrupt has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately preceding his bankruptcy.

Note should also be made of the very important Section 158 (3) of the Bankruptcy Act, 1914, as amended by Section 7 of the Bankruptcy Amendment Act, 1926, which provides—

For the purpose of this section, a person shall be deemed not to have kept proper books of account if he has not kept such books or accounts as are necessary to exhibit or explain his transactions and financial position in his trade or business including a book or books containing entries from day to day in sufficient detail of cash received and cash paid and, where the trade or business has involved dealings in goods, statements of annual stock-takings and (except in the case of goods sold by way of retail trade to actual consumers) accounts of



all goods sold and purchased showing the buyers and sellers thereof in sufficient detail to enable the goods and the buyers and sellers thereof to be identified.

This provision effectively requires that all traders should keep books of account proper to the particular trade or business in which they are engaged and, further, that such books shall be kept written up to date and periodically balanced. The revision of the provisions in regard to book-keeping made by the 1926 Amendment Act was intended to make it possible for the Trustee in Bankruptcy to trace how and for what consideration goods were acquired, and to whom and for what price they were disposed of, with the exception of goods sold in the case of retail trade, and the neglect to keep books in a business of any size now renders the trader liable to be convicted of a criminal offence if he should become bankrupt. It is true that persons commencing business rarely fear the possibility of bankruptcy but, in view of the number of failures which result from causes outside the control of the trader, the risk should not be regarded as negligible.

It is possible, however, that the fear of the Inspector of Taxes and his estimated assessments may be more potent as the cause of a desire to maintain reasonable and sufficient records than the fear of the Bankruptcy Court.

### **By a Firm Trading in Partnership**

Where the trading is conducted by a partnership, the position is somewhat different.

The Partnership Act of 1890 provides by Section 24, subsection 9, that—

The partnership books are to be kept at the place of business of the partnership (or the principal place if there is more than one) and every partner may, when he thinks fit, have access to and inspect and copy any of them.

Section 28 of the Act provides that—

Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal representatives.

The keeping of books recording its transactions is, therefore, a statutory obligation of all partnerships. There are no provisions as to what constitutes "books" or "true accounts." It should, however, as far as possible be kept before the minds of partners that the exigencies of life may require not only the satisfaction of the persons directly concerned but their legal representatives who may demand "true accounts and full information"; and this feature must in the case of a partnership be added to those already mentioned as persuasives to adequate book-keeping.

### **By a Company Incorporated under the Companies Act**

In the case of companies, the position is much clearer. The Companies Act, 1929, by Section 122, requires—

(1) Every company shall cause to be kept proper books of account with respect to: (a) all sums of money received and expended by the Company and the matters in respect of which the receipt and expenditure takes place; (b) all sales and purchases of goods by the company; (c) the assets and liabilities of the company.

(2) The books of account shall be kept at the Registered Office of the company or such other place as the Directors think fit and shall at all times be open to inspection by the Directors.

(3) If any person being a Director of a company fails to take all reasonable steps to secure compliance by the company with the requirements of this section, or has by his own wilful act been the cause of any default by the company therein, he shall in respect of each offence be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding £200.

And whilst the Bankruptcy Acts have no application to joint-stock companies, there are certain requirements in the provisions of the Companies Act, 1929, in relation to liquidation which should not be lost sight of.

Section 274, subsection 1—

If, where a company is wound up, it is shown that proper books of account were not kept by the company throughout the period of two years immediately preceding the commencement of the winding-up, every Director, Manager, or other officer of the company who was knowingly a party to, or connived at, the default of the company shall, unless he shows that he acted honestly or that in the circumstances in which the business was carried on the default was excusable, be liable on conviction on indictment to imprisonment for a term not exceeding one year or, on summary conviction, to imprisonment for a term not exceeding six months.

(2) For the purposes of this section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company including books containing entries from day to day in sufficient detail of all cash received and cash paid and, where the trade or business has involved dealings in goods, statements of the annual stock-takings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

In regard to the standard of book-keeping required, the statement of the Master of the Rolls

in *re Reed, Bowen & Co.* (1886) *ex parte Reed & Bowen* is applicable to all classes of traders—

In that case a scheme of arrangement was proposed and approved by resolution of the creditors, but the sanction of the Court was refused on the ground (*inter alia*) that the debtors had failed to keep proper books.

Lord Esher (Master of the Rolls) said—

It appeared that the debtors had seriously failed to keep proper books. They should have had books containing accounts of all their contracts. It was not enough that there should be something in the books which would take a skilled accountant a long time to make out. The books must be clear to anyone inspecting them. They had not been kept in anything like a proper manner. That was a serious offence. . . .

On the other hand, the provisions must not be pressed so far as to require a person to keep book records in relation to matters outside his business. In the case of *In re Mutton* (1887) the debtor had kept proper books in relation to his business but had indulged also in speculations in relation to land and buildings, these latter not being recorded in books. On his application for discharge, the Official Receiver reported that he had omitted to keep proper books of account in respect of those speculations. It was held that, although such non-business speculations affected his financial position, he was bound only to keep the book records which were usual and proper for his ordinary business transactions and such as would disclose his financial position as a man of business.

#### (b) IN RELATION TO THE ACCOUNTANT'S RESPONSIBILITY

The duty of the accountant and the responsibility he assumes in undertaking the completion of

incomplete records and the preparation of accounts therefrom will vary somewhat with the purpose for which the accounts are required. He is employed because he is an expert in accounts and holds himself out as ready to perform such professional service for reward; in doing so there is a legal presumption that he guarantees to his employer that he is competent to carry out the work and that it shall be carried out with the exercise of the skill, knowledge and care reasonably necessary for the purpose in hand. He must have regard to the purpose for which the accounts are required and he is relied upon as an expert to take such steps as are necessary to obtain satisfaction that the accounts, when prepared, are reliable and adequate for the purpose in hand. If he should fail to exercise due care and skill with the result that his client suffers damage, he may be liable to indemnify the client in respect of the consequence of such negligence. In presenting the result of his labours to his client, he should see that any limitations in the value of the result due to the materials available and any necessary qualifications are brought to the client's notice.

The accountant should, if possible, obtain his client's instructions in writing in order to obviate misunderstandings later, and in the absence of such instructions he will be well advised to write to his client accepting the engagement and setting out the instructions given to him, as he understands them.

The purposes for which an accountant may be required to prepare accounts from partial records include—

(a) That the proprietor, or proprietors, of the business may have information as to its position and the result of working.

(b) That a proper settlement of liability to taxation may be made.

(c) That the requirements of a lender or prospective lender may be satisfied.

(d) To provide material for use in negotiations in connexion with a prospective sale of the business or of an interest in the business.

(e) In connexion with investigations in insolvency.

(f) For the assistance of Executors in making probate statements and dealing with taxation claims upon them.

(g) The preparation of claims under policies in respect of losses in case of fire, etc.

It is immediately obvious that the precise work necessary and the extent of the verifications required will vary as between these different purposes.

The accountant will, therefore, keep the purpose for which his account is prepared in mind throughout his work, but there is the further possibility that accounts prepared for one purpose may be used for another purpose not contemplated in the original instructions; for example, accounts prepared for income tax purposes may be shown later to the Bank Manager. The point of view of the accountant preparing statements for taxation settlements will be the preparation of accurate statements of the profit or loss made over the period, whilst the Bank Manager will be more interested in the statement of assets and liabilities

involving the question of due verification and reasonable and appropriate valuation. It is well settled that an accountant is under no legal obligation in respect of negligence claims by third parties of whose existence he may be unaware at the time he does his work, and that no question of liability for negligence can arise until it is established that there was a contractual relationship between the parties (unless fraud can be proved), but the fact of such possible use should be remembered and the accountant's report drafted with sufficient fullness to obviate any reasonable risk of a third party altering his position in consequence of an assumption that the accountant, in preparing the accounts, had done work which, in fact, he had not done.

## CHAPTER III

### OUTLINE OF GENERAL PROCEDURE

#### I

It will be agreed by accountants of experience that there has been a great improvement in recent years in the adequacy of the records of business transactions, due in considerable measure to the pressure of the Inland Revenue authorities for satisfaction in regard to the true taxation liabilities of traders; but there are still many small businesses in which a good deal of "single entry" book-keeping persists. In many cases there are reasonably complete records of debtors, incomplete records of creditors and no record at all of the impersonal side of the transactions, whilst the trader is content to rely upon the bank pass book for information in regard to cash received and cash paid.

Examples may be cited—

(a) Cases were formerly numerous and are still encountered where a business is large enough to employ the services of several book-keepers, but the proprietor himself keeps a Private Ledger which he jealously guards, feeling it to be undesirable that the staff should see inside its covers. The result is that the Personal Ledgers, Day Books, Invoice Books and perhaps Cash Book are well kept but the key book is left over by its keeper for a convenient season which seldom, or never, arrives and incompleteness and inaccuracy follow.

(b) A traveller or salesman commences to trade



on his own account, or a skilled workman commences a small factory or workshop. In either of these cases the knowledge and appreciation of book-keeping is likely to be small and there will be no staff available with adequate experience of the work. Even where there is appreciation of the value of proper records, the proprietor, in the absence of assistance, may determine to keep personally such records as he thinks necessary, but he may be unable to find time, especially when business is good and there are more transactions to record. As long as the business is small enough for direct personal supervision he is not likely to feel the need of much in the way of book records.

(c) Small shopkeepers, whose sales are mainly for cash, often find it difficult to appreciate the necessity for promptness and precision of record.

(d) Professional people—doctors, proprietors of nursing homes, dentists, solicitors and others—are not infrequently content to allow an inadequate system to continue, provided the records are thought to be sufficient to enable charges to be made to, and collected from, their clients. Sometimes an accountant, or perhaps a commercial clerk, is called in each year to complete the accounts in the best way possible—in other words, a post-mortem examination and compilation.

(e) Where there is a change-over and a business previously conducted by an individual or a partnership is transferred to a private limited company whilst the same people remain in control, it is often found that there has been no “break” in the accounts. In some cases money may have been received before the incorporation of the company,

as the consideration for shares to be issued after incorporation, and used immediately in the business. In such cases it becomes necessary to reconstruct the position as at the date of incorporation for the purpose of completing the first accounts of the company.

(f) The position must be faced that inadequacy may be deliberate; it may be desired that the book-keeping shall not be too clear and accurate in order to conceal fraud—

- (a) upon the Revenue,
- (b) upon the creditors,
- (c) upon a partner, or
- (d) in relation to the sale of a business.

Where this is the case, the accountant who is instructed to complete the accounts will have need of all his experience and skill to avoid being led into giving a more complete or unqualified report upon the accounts, than the facts of the case really justify.

Whether the insufficiency of record be due to ignorance, carelessness, or to improper intent, accountants are eventually called upon to handle the matter, and it is often possible by the application of patience, tact, and professional skill to reach reasonably satisfactory results, even from records which at first sight appear most unpromising.

## 2

The first step towards preparing the accounts will be to make an investigation into the facts, the methods of business and the available records. The accountant will be well advised to begin operations by looking over the premises, especially

where there are manufacturing processes carried on. Then, he will give a thorough examination to the records kept ; some records there will certainly be. It may be found that purchases are dealt with purely on a cash basis with no record of outstanding liabilities ; there will usually be something in the nature of a Cash Book and there will generally be a Pass Book, which will be reliable as far as it goes—though the modern machine-prepared Pass Book, containing cheque numbers without names, is not so helpful as the older form.

On the other side, unless the sales are wholly for cash, there will be some record of debts due to the business. Invoices outward may be entered in a Day Book or posted direct to the Ledger Account of the customer.

It is desirable that in all cases of partial record, if the proprietor has a personal bank account in addition to his business account, this private Pass Book should be examined by the accountant, as much by way of precaution against the payment of business expenses out of private funds as the contrary. Inquiry should also be made as to deposit accounts, with the Bank or with a Building Society or the like ; where book-keeping knowledge is small there may easily be confusion in regard to items in these accounts.

From the point of view of the investigating accountant, accuracy is a great deal more important than system, and weird systems of single entry, which the accountant is satisfied can be relied upon, may be very helpful.

A list of the books available and offered for examination should be made, together with notes

of any other records kept, however fragmentary, and care should be taken that consideration is given to all such books and to the amount and value of the information therein. In *Pendleburys Ltd. v. Ellis, Green & Co.* very great importance was placed upon the question as to whether the accountants were, or ought to have been, aware of the existence of a book described as a "daily cash received book." Evidence was given that the auditors' working papers included reference to all the books examined but no reference to that particular book, and the clerks engaged upon the detail work were able to state positively that it had not been brought to their notice by the Directors or staff of the claimant company and that they were quite unaware of its existence. The position might have been much more awkward for the accountants if it had happened that their papers had not disclosed a full list of the books presented to them, and it is thought that the principles there applied to an auditor would be applied—*mutatis mutandis*—to an accountant engaged in completing accounts.

At any rate the case indicates how important it is that an accountant should give sufficient consideration to each book which comes to his knowledge, however apparently incomplete in itself, so that he may be sure he is getting from it whatever of value for his purpose it may contain.

In general, cases of partial record may be set out in two classes, the methods to be adopted being appropriately varied—

1. The cases in which it is found that the books maintained are, or contain, a record of cash and

transactions satisfactory as far as it goes and capable of being completed.

In such a case the accountant will test and check, as necessary, the records he proposes to use, make whatever additional analysis is deemed to be desirable in the circumstances, and proceed to post up impersonal accounts either directly or from summaries or abstractions from the books and papers, so completing the records. He will then prepare a Trial Balance on the books in the usual way.

2. Cases in which the accountant, after inquiry and testing decides that it is necessary to build records up from such bases as are available and to prepare his own working statements, making such use as may be possible of the records which have been maintained. In the course of this work it will be necessary to prepare a statement of affairs at the beginning of the period for which the account is being prepared, unless such a statement is available.

It is often worth while to take time at the beginning to collect all available documents likely to be useful and to sort them in order—easy reference may save much time.

### **Total Accounts**

In the majority of cases the accountant will find it most satisfactory to work on a cash basis and to make cash summaries the foundation on which he builds. The most generally useful method of procedure is to prepare total accounts of bank and cash and to collect the information from these and other sources on to a Working Sheet, bringing in

at that point the outstanding items, such as debtors, creditors, and stocks.

The items in the Pass Book will be vouched as possible and necessary; the payments side with invoices, statements and receipts, and the receipts side with counterfoil receipt books (if any), bank paying-in books, etc. The purpose of the vouching is the confirmation of the items appearing in the book as charges against the business, and in relation to the allocation and description of the aggregate totals in the accounts when drafted; even where there is no audit in the technical sense, the accountant employed to prepare accounts from imperfect records should regard himself as responsible to substantiate as far as possible the figures he uses.

It will often be found that useful notes as to the source from which money has been received have been made in the counterfoil of the paying-in book, and similarly the counterfoils of cheque books are well worth consideration in cases of doubt, or where a voucher for the payment is missing.

In all but the smallest cases some kind of Wages Book will be kept; this will be used as confirmation of payments. Also consideration must always be given to the treatment of national insurance, as it will sometimes be found that the stamps are bought irregularly in quantities and not affixed to the cards each week; in such cases it will usually be found that the stamping is in arrear at the balancing date—there may be a stock of stamps, or money to buy stamps, in the office but it may be inadequate.

Payments or receipts from which income tax is deducted, such as interest or ground rents, should

be carefully noted as found; it is probably desirable that these payments should be shown in the working papers gross, with the tax as paid or received.

After consideration has been given to these and similar matters, summaries of payments and receipts will be made, with the object of grouping the items under headings appropriate for use in the accounts. The payments analysis will show the cost of materials or goods purchased for resale in one total and, under appropriate headings, the other expenses of the business, care being taken to keep any expenditure on Capital Account separate from trading expenses.

The receipts analysis should indicate cash sales and payments received from debtors separately, if possible, and also any necessary separation of other items of receipt, as, e.g. income from investments, rents received, receipts from the sale of assets, or other non-trading items.

In some cases, where a Private Ledger is in existence, postings direct from the Pass Book to accounts in the Private Ledger are made and a Bank Account opened therein for the contra entries in total.

The total Bank Account can then be set up, beginning with the balance at bank at the beginning of the period, debit or credit; debiting total bankings for the period and crediting the cheque payments under the several heads which it is proposed to use in the accounts; the balance on the account will then agree with the bank balance at the close of business on the day of the account. When working in this way from a bank summary,

the proper treatment of outstanding cheques must be remembered; it is very easy to overlook this. (For a *pro forma* example of such a Bank Total Account, see No. 1, page 75.)

It is always desirable that receipts should be banked in full and payments, other than petty cash, made by cheque; but in the class of case now under consideration it will often be found that this has not been done. If it has, there will be no need of further cash summary. Usually, however, it will be necessary to deal with the cash in the same way as has been described in the case of the bank receipts and payments. Reliable information is likely to be less complete, but that which is available will be assembled and supplemented by estimates, etc., as necessary. All cash traced as received will be debited to the Cash Total Account and all bankings will be credited; there will be further credits in respect of payments made out of cash, as far as information is available. The matters of chief difficulty are likely to be the cash takings on the one side and the personal drawings by the proprietor on the other, and these can only be dealt with according to the circumstances ascertained in each case. (Cash Summary, see No. 2, page 76.)

The Total Accounts should be set up in as full detail as is reasonably possible. It will often happen that, as the work proceeds, detail which at first seemed to be superfluous will prove most helpful.

It is thought that the most convenient way of collecting the figures from the various summaries and other sources is by preparing a Working Sheet



in the form No. 5 shown on page 78. For this purpose, obtain analysis paper ruled with about a dozen cash columns, write the names of the impersonal accounts down the side of the sheet, in the first two columns enter the Statement of Affairs as at the beginning of the period in "Balance Account" form, that is, with the assets in the debit column and the liabilities in the credit. In the next two columns enter the information collected in the Bank Total Account in the form of postings to the impersonal accounts—that is to say, on the opposite side to that in which the items appear in the Total Account itself. If there is a Cash Total Account, use the next two columns for this. It is worth while to write up all corrections and adjustments as the items are discovered in the form of Journal entries (No. 3, page 77), with adequate narration, and to allot two columns on the Working Sheet to these Journal adjustments; including in the journalization apportionments, unexpired values, outstanding invoices, etc. In appropriate cases careful consideration will be given to the value of the consumption of goods out of the business stocks or products by the proprietor or his family, and the result will be journalized. Then the last four columns on the sheet will be headed "Profit & Loss a/c" and "Balance Account" respectively. Each of the pairs of columns will be totalled and agreed, debit and credit, and the cross additions will give the total figures for insertion in the Profit & Loss a/c and the Balance a/c columns, against each sub-heading. This Working Sheet will be supported by schedules giving whatever detail is regarded as

necessary or likely to be useful. In setting up the financial statements, the Balance a/c items, of course, appear on the side of the Balance Sheet opposite to that on which they appear on the Working Sheet. (See Nos. 5 and 6, pages 78 and 79.)

### **Ledger Analyses**

In some businesses it will be found that entries are made directly in the Personal Ledgers, which are carefully kept and reliable—this may apply to sales only, or to both sales and purchases. In such cases it is usually worth while to analyse the Ledger; it is not so long a task as might be anticipated, and in any event it will be necessary to examine such accounts in detail. For a Debtors Ledger analysis the columns of a sheet of ruled paper should be headed—

On the debit side—

- (1) Opening Balances due to the trader (any credit balance being entered here in red).
- (2) Goods charged out.
- (3) Any adjustments.
- (4) Total.

On the credit side—

- (1) Returns and allowances.
- (2) Cash received.
- (3) Discounts.
- (4) Bad Debts written off.
- (5) Balance (debit balances being entered here in red ink).
- (6) Total.

The names or folios will be entered on the left-hand side of the sheet, one line being given to each account, and each account analysed as it is examined. The sheets will give a total account on the Ledger, particulars of sales, credits, cash, etc., so providing a complete summary of the transactions on credit for use together with, or in confirmation of, the cash analyses. If transfers between accounts are numerous it will be worth while to include a "transfers" column on each side.

The Creditors Ledger, if similarly kept, may be analysed in the same way, the columns being, of course, appropriately headed.

Where credit transactions of both purchase and sale can be so dealt with, only cash transactions and expense payments will be left for separate treatment.

### Queries

Queries raised during the course of the work should be listed on one half of a sheet, or a page of a note-book, and the answer received set out opposite thereto in each case. Care should be taken that the notes and answers are in sufficient detail and written with sufficient clearness to be intelligible when the person making the note is no longer available for reference and explanation. It is a matter of routine that is perhaps worth comment, that it is usually more satisfactory to both parties and economical in time for queries to be noted as they arise and left to be settled in bulk, rather than individually; also, as the work proceeds, the answers to many of the queries will be found.

## 3

When the analyses have been made and the records completed as far as possible, the task of building up accounts and considering the results disclosed must be taken in hand. This will give scope for the exercise of considerable skill and judgment and in no part of the professional duties of an accountant are the advantages of experience more evident.

In many cases, some estimates will have to be made and the results, taken as a whole, considered; it is possible for estimates, each of which can be defended individually as reasonable, to produce, when combined, a result which is unreasonable. Obviously the estimates of different people based on the same facts may differ widely. No hard and fast rules can possibly be laid down for the purpose of arriving at reasonable results from partial records, or for the criticism of the results when stated; each case must be considered on its own merits. In some cases it will be possible to obtain or abstract statements of quantities of materials used, or of purchases, and to calculate the relative production or sales quantity for the purpose of obtaining a broad basis of comparison with the figures in the draft financial statement. Such manufacturing costs as wages, materials, power, normally bear a constant ratio to each other in a particular business and to the value of its product; consideration of the available information along these lines sometimes throws a flood of light into a dark place. There may be costing records of greater or less value which will give some assistance. It is often possible to examine carefully the

sales for a short period and to arrive at a fair estimate of the rate of gross profit earned, which average rate may be very usefully applied in confirmation of the results shown for the longer period under examination; it is very rarely the case that profit percentages from other similar businesses are of much real utility as a guide, or basis for estimations—for reasons which will be indicated in more detail below.

As soon as more than one period is available for comparison, the various figures for the respective years should be set out in tabular form and the fluctuations in the several years considered item by item.

Standing charges are capable of easy confirmation and the importance of such confirmation should not be overlooked.

Accountants are well aware that for taxation purposes it is the custom of Inspectors of Taxes to compare the results of similar businesses in the same area, and when an unusual variation in the rate of gross profit shown in an account submitted is observed on comparing it with the averages on record, inquiry is made into the cause. It will be found, however, that unless applied with detailed knowledge and considerable caution, gross profit percentages taken from other businesses in the same trade may be misleading and their adoption for the purpose of estimating results cannot be recommended. An example may be considered which will at the same time indicate pitfalls to be avoided.

The accounts of four bakery businesses, each of which can be relied upon, and each of which has a

turnover in the region of £8000 per annum, show widely different results for approximately the same trading period—

No. 1	Gross Profit	30%
2	" "	25%
3	" "	22%
4	" "	18½%

The explanations are found to be as follows—

*No. 1—Gross Profit 30% £2400.* A good general business, efficient buying and management, careful supervision throughout bakehouse, shop and rounds, up-to-date plant. There is a considerable sale of pastries, cakes and smalls—on which there is a larger margin of profit than on bread.

*No. 2—Gross Profit 25% £2000.* There is a steady trade, mainly in bread; the turnover includes pastries which are bought elsewhere for resale, the business having insufficient plant for making these.

*No. 3—Gross Profit 22% £1750.* A large part of the trade done consists of the supply of "smalls" to hotels, etc., the profit on which is severely restricted owing to local competition for the contracts. Also this business has a relatively low bread output per sack of flour used.

*No. 4—Gross Profit 18½% £1480.* This low rate of profit was mainly due to substantial forward contracts for flour purchase, made in anticipation of an upward trend in flour prices, whereas the price of flour fell for some months and bread was actually being sold at little above cost for part of the period covered by the account.

Other factors of variation in small bakery businesses are—

The proprietor may act as his own foreman in the bakehouse, saving perhaps £5 per week on the productive wages charged in the account.

A very important matter affecting gross profit in this trade is the number of loaves produced from a sack of flour. Some bakers turn out 94·5 quartern loaves per sack, others fall as low as 91.

In a properly organized business the records of

outturn per sack of flour are carefully noted and closely watched by the management, but in a business the records of which are incomplete there may be no such information available. If the trader is unaware of the outturn rate of his bakery, he should be asked to go into the matter and make several tests on different occasions, so as to establish an average for his house.

It will be seen from the foregoing that round percentages relating to these apparently comparable businesses would be of little value. The turnover in each of the cases cited above is substantially the same, but there is a difference of £1000 between the gross profit shown by the first and last of the four, and only a detailed knowledge of the circumstances of each enables an explanation to be supplied. It will be found in practice that most businesses present individual features, and similarly variant factors will be found operative in most trades, so that general percentages of profit are subject to such wide margins of variation as to be of little practical value.

#### 4

Having considered the general principles and methods we may set out a summary of the work to be done in a typical case—

1. Obtain signed instructions from the client as to the scope of the inquiry, or write him an acceptance of the instructions, setting these out.

The letter of instruction is often drafted by the accountant, and it should cover authority to investigate all matters likely to be of assistance in the inquiry.

2. A history of the business, including information as to its capitalization should be obtained and put on record.

3. Inspect the premises, note the nature of the plant and the space available for storage; methods of business working; proportion of premises used for the business if the trader lives on the premises, or sublets a part.

4. Have produced and list up all records relating to business matters. It is desirable that this should be signed or initialed by the client.

5. Obtain a statement of all banking accounts, including Bank Deposit Accounts, Post Office Deposit Accounts, Building Society Accounts, etc., including also any in his wife's name; and authority to obtain bank confirmation thereof.

6. The work can now be commenced in detail. If no Cash Book has been maintained, prepare total accounts based on the Pass Book in the manner already described.

It is good practice for principals who are not themselves in continuous contact with the detail of the work, to obtain a written report thereon from the staff actually engaged. The report will set out all relevant factors and considerations, it will include a schedule of books, etc., examined, will detail the work done, with reasons, and specify any matters to which the principal's attention is directed, or on which his decision is necessary.

This report will be treated as strictly confidential. It will be considered carefully when completing the accounts and report as drafted and passed in for the principal's approval, completion



and signature. The internal report will be preserved for reference later if needed—it may be so needed years later when the staff engaged on the work are no longer available for reference and consultation.

The preparation of such a report is good for the staff as requiring a review and comment on the total facts and factors of the work on which they have been engaged, and it is invaluable for the principal's consideration and reference.

The form of the financial statements for the client, presenting the result of the work done, should receive careful consideration. It may very well be that the form in which the accounts are built up in the accountant's working papers for his own detailed consideration is not the best way in which to present the result to the non-technical mind of the client. It may be that a narrative form (No. 6a, page 80) starting off with the sales, deducting the "cost of sales" (purchases adjusted by stocks, or materials used plus wages) and showing gross profit, then by a further deduction of establishment charges, etc., arriving at net profit, will be more easily grasped than the conventional debit and credit form. The skill of the accountant will be shown by his ability to draw up a form of account which the particular person to whom it is presented is able to understand easily—whether that person be familiar with books and accounts or completely inexperienced.

## CHAPTER IV

### CERTAIN MATTERS REQUIRING SPECIAL ATTENTION

It may be useful to enumerate and comment on a number of matters which frequently arise and require consideration in this class of work.

(1) *Sales and Purchases.* In the case of bakeries, to which reference has been made for the purpose of illustration, there will be knowledge as to the number of sacks of flour used per week; and if the baker is also aware of the average number of loaves obtained from each sack of flour used in his bakehouse and can estimate the flour usage for "smalls," etc., a useful check on both purchases and sales will be available.

Other trades have their own checks of a parallel nature and if the accountant has experience of the trade, he will be aware of these; in the absence of such experience he should make such inquiries of his client, or elsewhere, as he thinks proper and use the result of his inquiries for confirmation of the result reached from a consideration of the book and other records available. An accountant whose practice in any trade is considerable will find time spent in scanning the pages of the principal trade journals well repaid.

The accountant will bear in mind that sales may be omitted altogether, or entries of purchases may be duplicated. This is especially a danger to be guarded against, as far as possible, when working on a cash basis. Fictitious purchases will, of

course, inflate the charges against trading and reduce the profits shown in the accounts, and the omission of sales may provide the proprietor with unrecorded drawings, on which he escapes the payment of income tax; but the omitted sales may not be to the advantage of the proprietor. In a bakery business, roundsmen, shop assistants and other employees may be the responsible parties, particularly when they are aware that records maintained are meagre. Where quantity tests of any kind are available, they form the best possible assurance against this risk, whatever be the source of the risk.

(2) *Stocks*. The matter of over- or under-enumeration or valuation of stock is of the greatest importance and the possibility that goods may be actually in stock and recorded and valued as being in stock in respect of which invoices have not been passed through books kept on a cash basis only, or in some trades in consequence of a forward dating arrangement, should be borne in mind. (See No. 6, page 79.) It is also possible that goods may be purchased for delivery to buyer's order and invoices for the whole purchase passed through the books though, in fact, only part delivery has been given or taken. It should not be assumed that goods are always invoiced as and when delivered. Goods may be bought or sold on instalment or hire purchase terms and it may simply be by oversight that the accountant is not told of such transactions, but wrong treatment may have serious effects upon the accounts prepared and where the records are very incomplete, omissions of this kind are easy.

Stock will normally be valued on the basis of "cost or market value, whichever is the lower." In retail businesses especially, considerations in regard to shop-soiled goods, goods out of fashion, or otherwise unsaleable and their real present value will be important.

(3) *Work in Progress*. Not less important is the matter of a proper statement of work in hand; even in a small workshop the item may be relatively important.

In the *Westminster Road Construction* case, the profit was over-stated because of a lack of complete information as to the value of work in hand and as to sub-contractors' charges in connexion therewith; consequently a dividend was paid on the faith of the account and, not having been earned, it was paid out of capital. The accountant who had prepared and audited the account on which the directors acted in declaring the dividend, was held liable in damages for negligence. This case related primarily to his duties as an auditor who had both prepared the account and audited it, but in such cases his responsibility in the two functions is difficult to disentangle and it is thought that the position of an accountant preparing accounts in a parallel case would be very similar.

(4) Wages may be inflated and not only by employees; employers have been known to include "dummy" men in the pay-roll and to take the wages of the "dummies" themselves, and domestic servants have been paid out of business funds, either of which, of course, constitutes a cash drawing charged against the trading for the period.

If manufacturing is conducted, the records of employees for the Inspectors under the Factories Acts may be useful as confirmation as well as the inspection of the stamped Health and Unemployment cards of the staff.

(5) A list of amounts outstanding due to creditors at the date of the account will have to be prepared, and an effort should be made to collect creditors' statements as at the date of the Balance Sheet or later (or receipted statements embodying subsequent payments) for the purpose of ensuring that all purchases have been brought into account. The list of debtors should be confirmed as far as possible by the consideration of subsequent payments or other available matter, so confirming the records of sales.

(6) In some trades there may be considerable forward contracts for purchase or sale, and inquiry should be made and the available information considered.

Such forward contracts for purchase and sale may be approximately equivalent—that is, materials purchased forward may be adequate for the manufacture of finished goods sold forward, or one or other may be largely in excess, constituting speculative buying or selling. If the values involved are material, a reference to any contingent liability should be included on the face of the Balance Sheet.

In this matter, it will be realized that a financial statement may be false by an omission which vitiates the picture presented by an account, every positive statement of which is true, as well as by directly false or inaccurate statements.

The fact that forward losses are not allowed as charges for income tax purposes, nor are forward profits chargeable to tax until they have been realized, should not be regarded as decisive in respect of the proper statement of the accounts of the business.

(7) The factors of depreciation, obsolescence and any necessary amortization must not be overlooked. The small trader himself often forgets such matters as the annual decrease in value of leasehold premises, and if he is maintaining his plant or a motor van in working order by executing needed repairs and making replacements from time to time, he will persuade himself that these assets are not materially depreciating. These matters must be kept before the client by the accountant and, when necessary, reference made thereto in the account prepared or in his report.

(8) It will usually be found that certain estimates have to be made and in this regard, personal observation by the accountant and the exercise of his own judgment, developed in experience, will be the best guide as to reasonableness. No two cases are alike and no general rules can be laid down. Estimates should normally be made by the client, or his staff and the accountant should aim at giving unbiased consideration thereto. In some businesses, meals are supplied to staff, or employees may "live in," such costs being effectively an increase of wage paid. Care must be taken to make appropriate adjustment; as, e.g. if they live with the employer, the cost must be estimated and credited to his drawings on some reasonable basis.

(9) Caution is always necessary in dealing with the proprietor's drawings; consideration must be given to the rate at which he is believed to be living, and even if it should be found that the drawings are approximately of the amount anticipated after such consideration, the question must not be regarded as closed; for example, if it is assumed that the proprietor of a business is living at the rate of about £500 per annum and it is found that the drawings which can be traced amount in total to about this sum, it will still be necessary to ask how those drawings were made. It may be that a substantial part of the sum was drawn in the form of cheques payable to personal creditors, and if it should happen that the £500 charged as drawings included a large cheque to a seller of furniture, for the purchase of a motor car, or to pay medical and surgical fees, it will be realized that the actual amount left for living expenses is very much less than the £500 suggested as the rate of living.

Also it may sometimes be found that obviously excessive wages are recorded as paid to young members of the trader's family living at home—a form of "drawing" which the accountant may feel it necessary to bring to the notice of the Inspector of Taxes, if he is responsible for the taxation settlement.

(10) Special consideration must be given in partnership cases to the inter-relation between partners. The accountant will regard himself as an agent severally as well as jointly of the partners, and he will remember that one partner may be responsible for the accounting of the business and

may deliberately refrain from making full information available to his partners. The Partnership Agreement should be carefully perused, any instructions received from a single partner should be confirmed with the others, or a reference thereto should be included in the report which is eventually made, so that it is brought to the notice of the others, and it will be necessary to see that the accounts are stated in sufficient fullness or that his report gives the information necessary to ensure that the action taken on all questions of material importance is brought to the notice of each partner.

(11) In all cases, the accountant will give consideration to the distinction between capital and revenue, and make careful inquiries as to any assets bought or sold during the period, or additions made to plant, etc. Capital expenditure consists of the cost of assets acquired for the earning of the profits of the business, or for increasing its earning capacity, whilst revenue expenditure includes all costs necessarily incurred in maintaining the capital assets in an efficient condition. It may be difficult, in some cases, to obtain satisfactory information in relation to the replacements of assets in respect of which wear and tear is allowed in the income tax computations, and the trader may more or less innocently fail to appreciate the necessity for treating any such replacements as capital charges; he may, of course, do as he thinks fit for the purpose of his own accounts, but regard must be had to the proper position in relation to the preparation of computations of profits for assessment to income



tax, where the accountant is also dealing with that matter.

### **Balance Sheet or Statement of Affairs**

The accountant engaged in the preparation of accounts from partial records will be well advised to give close attention to the statement of floating assets and liabilities, verifying these item by item and endeavouring to confirm, as far as possible, all outstanding personal balances, both debit and credit, by creditors' statements, or debtors' subsequent payments. He should scrutinize in detail the accounts with debtors and creditors and examine the "make-up" of each such balance carried down at the date of the account, satisfying himself that the balance consists of specific items and is not an accumulation of unpaid and disputed balances. From this consideration he may discover items being set off *in contra* in respect of which proper entries have not been put through the books, erroneous charges, disputed items or disallowed claims remaining uncleared in the account. These will be noted and useful information may be obtained in relation to doubtful debts, in respect of which provision should be made for probable losses in collection.

If any bills receivable were in hand at the date of the account, the proceeds should be traced, or the bills seen.

Trade discounts should not be carried in the debtors' balances in any circumstances, but brought immediately into account in reduction of sales, and it is desirable that provision should be made in respect of cash discounts allowable.

When information is available in respect of more than one period, the accountant will consider the comparative ratio in different periods of sales debts outstanding to sales, etc.

Consideration should be given to the enumeration and bases of valuation of such assets as stock, loose tools, stores, work in hand, items on hire purchase terms, or in course of payment by instalments.

The position in regard to contingent liabilities and outstanding claims against the business should by no means be overlooked. It may be necessary to include a note on the face of the Balance Sheet in relation to the facts in regard to these matters.

The term "Balance Sheet" is usually regarded as implying that the balances therein have been taken from the books of the trader. Where this is not the case, it is as well to use the alternative expression "Statement of Affairs."

## CHAPTER V

### PRACTICAL ILLUSTRATIONS

EACH case of "partial record" presents its own problems and in no two cases will the material available be exactly similar. The method of approach can only be decided after individual consideration, but for the purpose of illustration, it may be desirable to cite and describe briefly some specimen cases of incomplete records, and to comment on the methods employed for the preparation of accounts therefrom.

#### (a) Small Engineering Shop

A is a skilled workman who set up a workshop and himself kept such records as he thought necessary. These records consisted of a Cash Book and a Debtors Ledger. In the Debtors Ledger, he opened an account for each customer; all goods sent out were invoiced in duplicate, a carbon copy was kept, and he entered the invoice in the Ledger Account of the debtor, putting the folio on the copy invoice. All cash received was duly entered in the Cash Book and posted to the credit of the respective debtors. All payments, whether by cash or by cheque, were supposed to be entered in the Cash Book and, with a few omissions, they were so entered.

As far as possible, he avoided making cheque payments in the last week of each month. He agreed his Cash Book with the Pass Book by counting any cash he had in the office and entering in the Cash Book as "Sundries" such an amount

as would give a balance equal to Pass Book balance plus cash in hand.

He kept his inwards invoices on a file, and as statements of account came in from creditors, he examined them with the invoices and, if in order, paid them, putting the receipts on another file.

Wages (including his own) he paid himself, drawing a cheque weekly for the purpose. He likewise paid sundry petty expenses from his personal cash or cash received and, as far as possible, remembered to enter these in the Cash Book.

At the end of his financial year, he obtained the assistance of a commercial clerk and, together, they prepared a statement for the Inspector of Taxes, which was certified by the proprietor as a true Profit and Loss Account. No Balance Sheet was ever drawn up. They went laboriously through the Debtors Ledger, added up all the debits and entered the total on the credit side of the Profit and Loss Account, for the other side of which they made an analysis of the payments by taking sheets of paper headed respectively "Purchases," "Wages," "Rent and Rates," "Office Expenses," etc., going item by item through the Cash Book payments and putting them under the heading on the sheet which they thought appropriate. The totals of these various columns were entered on the debit side of the Profit and Loss Account. Stock was estimated by the proprietor without precise enumeration, and the balance of the statement so prepared was regarded as the profit for the year.

For a number of years, this statement so certified by the proprietor was accepted by the Inspector

of Taxes. The business steadily grew and by and by a clerk was employed, but no material change was made in the method of accounting, and the clerk followed precedent and prepared Profit and Loss Accounts in the same way. Eventually, there came a year in which the profit shown fell very considerably, and then the Inspector suggested the employment of an accountant and the production of accounts prepared by him. As mentioned above, nothing in the nature of a Balance Sheet had ever been attempted.

The accountant proceeded as follows—

(1) He made an analysis of the Debtors Ledger in the manner described on page 25. He went through the books of carbon copy invoices and saw that each had a Debtors Ledger posting folio, had the total of these invoices abstracted, and found, after certain adjustments, that it agreed approximately with the total in his Debtors Ledger analysis.

He checked all postings from the Cash Book to this Ledger, correcting and completing, especially in regard to discounts and allowances.

He prepared a list of personal balances at each end of the period with which he was dealing, and set up a total account on that Ledger.

(2) The balances at the beginning and end of the period had been agreed with the balances as shown by the Pass Book plus cash in hand by entering the difference as "Sundries." The accountant vouched the Cash Book throughout so far as vouchers were available and, in the course of doing so, found a number of vouchers for payments which had not been entered. The entry of these

materially assisted in explaining the "Sundries." The accountant also found various other matters calling for adjustment and correction and eventually made a reconciliation with the Pass Book at both ends of his period. He next made an analysis of cash payments. Throughout this work, of course, he kept a watchful eye for capital items and non-business items and dealt appropriately with these as they were found.

(3) The proprietor prepared a list of the machines, trade fixtures, tools, etc., and also of the office furniture as at the end of the year, and as nearly as possible a list as at the beginning of the year, and these he valued to the best of his ability. He also made the best statement then possible (some months after date) of the stock at the end of the period.

(4) A list of creditors at the year end was prepared by considering all payments made on the statements of account received between the year end and the date of the preparation of the statement and listing items relative to the year under review together with any still unpaid. Any creditors outstanding at the beginning of the year were allowed to fall into the year's account because there had been no provision for them in the statements prepared for the estimation of the profits for the preceding year.

The accountant was then in a position to prepare an approximate statement of affairs as at the beginning of the year; he took the stock at that date as at the figure used in the last taxation statement; machinery, trade, fixtures, tools, etc., at the valuation made, confirmed by a consideration

of purchases and sales during the year. For the debtors he had the opening balance of his Debtors Ledger analysis; he brought in nothing for the creditors or for any unexpired values of insurances or other payments in advance. The balance at the Bank was taken as per Pass Book and the difference between that and the balance brought forward in the Cash Book was taken as cash in hand. The statement was balanced by entering the difference between the two sides as Capital.

This statement of affairs, together with the particulars abstracted and the other analyses prepared, was used to draft a working statement in the form set out on page 78. (No. 5.)

A Private Ledger was written up from this working sheet and arrangements made for a simple form of book-keeping to be maintained in the future which would enable the accountants to complete annual trading statements for future periods with a minimum amount of trouble.

As a postscript, it may be added that the profit, as shown by these first accounts, did not differ very materially from that which the proprietor had himself submitted to the Inspector of Taxes. The accountant had an interview with the Inspector, described the work done and the course adopted; an undertaking was given that proper accounts should be kept for the future and duly audited, and no difficulty was experienced in arriving at a settlement with the Inspector, reasonably satisfactory to all parties.

**(b) Tailor**

*B* is a tailor who does his own measuring and cutting out and gives work out to be made up. Some of his workers work in their own homes and others run small workshops employing several workers. They are paid for work done and not on a time basis. The tailor keeps carefully a kind of costing book in which he sets down each order received, giving it a serial number; in the next column he records his estimate of the cost of the cloth used as he cuts it out; in another column he enters the estimated cost of sundries, buttons, trimmings, etc., as handed out to the workers; in the next column the amount to be paid to the worker for making up in respect of each job. He then makes a cross addition which gives his total prime cost for each job, and in the last column enters the price charged to the customer. By the addition of the last two columns and the subtraction of the total "cost" from the price charged, he arrives at an approximate gross profit on working month by month. All work done, repairs, alterations, etc., is entered in this book. In addition to this book, he has a Pass Book, Wages Book showing the weekly payments, and a "Purchase Book" which is simply a list of invoices inwards marked off as paid, and a little memorandum book of petty cash. He also keeps a Debtors Ledger in which he enters credit sales direct and, of course, payment therefor as it is received. He draws, in his weekly wages cheque, a regular amount for himself, banks most of the cash taken and pays nearly all creditors by cheque.

The explanation of this rather unusual system is



that this tailor was for years the cutter for a large and well-organized concern and then kept such a costing book as part of the full accounting system. The course adopted by the accountant, who is called in annually to complete the accounts, is—

(1) To make a summary of receipts and payments from the Pass Book, after such vouching as he finds necessary, and reconciling the total drawn for wages with the total of the Wages Book, plus proprietor's drawings, the difference being treated as petty cash to be accounted for.

(2) To list and total unpaid invoices as per Purchase Book and agree the total of that book after adjusting outstandings at the beginning and end of the year with the Pass Book analysis.

(3) To analyse Debtors Ledger and list amounts outstanding at date.

(4) He then compares the estimated total cost of materials in the Costing Book with the total arrived at from the Pass Book analysis, after adjusting outstanding creditors and stocks at each end of the account. If the difference should on any occasion be considerable, it would be inquired into with the assistance of the client.

(5) He then considers similarly the total charges to customers as entered in the Costing Book with "Sales" as calculated from Pass Book lodgments adjusted by outstandings from the Debtors Ledger.

(6) The value of the work in hand is arrived at from the Costing Book and stocks are enumerated and valued.

(7) From the foregoing particulars, no difficulty is experienced in completing a Private Ledger and drafting accounts of the working for the period.

**(c) Retail Shopkeeper**

C is a retail shopkeeper who started in a small way with one shop many years ago. He has been successful and now has half a dozen branch shops, all in the same area, and each more or less under his direct supervision. The branch shops are supplied from the original shop, now, of course, very much enlarged. Practically all trade is for cash.

In the days when he had one shop, he kept a general Cash Book himself, entered all receipts in daily totals from the till sheet, made a considerable number of payments out of cash, entered these payments in his Cash Book (more or less accurately) and made a daily banking of such an amount as would leave him a small balance of cash in the shop for change money. Larger payments were made by cheque and duly entered in the Cash Book. His accountant periodically examined the Cash Book, checked it with the Pass Book and with vouchers and, as far as he found it necessary, examined the till sheets in confirmation and for corrections. He prepared an analysis of both sides of the Cash Book quarterly, and from that analysis posted the impersonal accounts in the Private Ledger on a cash basis. At the end of the year, outstanding debtors, creditors, stocks, etc., were brought in, to enable accounts to be completed.

The trader has now formed his business into a private company, the shares in which are owned by himself and his family. He still keeps his Cash Book and regards the suggestion that he should delegate this work as a species of sacrilege; his various branch shops bank their cash takings

daily, after deducting small payments made in cash, and he receives from each shop a daily statement of—

- (a) Cash takings.
- (b) Payments thereout.
- (c) Bankings.

These particulars he enters in the Cash Book. A Wages Book is kept at the principal shop and a cheque is drawn for the weekly amount. There is also now a Petty Cash Book, fed from the main Cash Book, and there are single entry accounts of certain credit customers.

The accountant still makes his quarterly analyses of the Cash Book and also the Petty Cash Book, examines the Wages Book and the personal accounts kept, and brings in the balances of debtors and creditors at Balance Sheet date, just as he does the stocks.

The system is not one which can be recommended; it is definitely incomplete, but it does permit of completion by the accountant in a way which enables him to obtain satisfaction that the Balance Sheet prepared in due course presents a true picture of the position of the company at its date.

#### **(d) Builder and Contractor**

*D* is a builder and contractor who obtains contracts for building work and does a small amount of speculative building on his own account. He has no permanent staff except a foreman, acts as his own clerk of works and engages workmen—carpenters, bricklayers, plasterers, etc.—as he

needs them for his several jobs. His business records are meagre but, fortunately, he is a methodical person, pays all receipts into the bank (there are no small cash receipts), keeps a full Wages Book accurately, including National Insurance, and draws a weekly cheque to cover wages, petty cash payments and his own drawings. When making out cheques for creditors' accounts, he writes on each invoice the name of the job for which the purchase was made. No stock except loose plant is carried in this particular case.

He presents his accountant with the Pass Book, the Wages Book and two files of vouchers, one of which relates to bank payments and the other to petty cash payments. Experience proves that the files of vouchers are practically complete (though not in order!), the bank Pass Book can generally be completely vouched, and the summation of the cash payments as per vouchers, together with wages as per Wages Book, gives a total of the weekly cash expenditure, the balance of the weekly cheque being debited to the proprietor as drawings.

The accountant is asked to prepare an annual statement showing the total result of the working for the year, for the client's own information and for the settlement of his taxation liabilities.

The course of the accountant is fairly clear—

(1) He vouches the Pass Book and makes an analysis of the payments. He is not asked to arrive at the separate results of the different contracts but the invoices, having the names of the jobs written on them, enable him to see what payments have been made on uncompleted work.

(2) The accountant gives careful consideration,

in consultation with the client, to the position of the uncompleted contracts, and by carrying his consideration of the Pass Book and the voucher files beyond the date of the account, he can arrive at the outstanding liabilities.

(3) The contracts undertaken are few in number and it is, therefore, easy to trace payments from the Pass Book and to complete a statement of debts outstanding due to the business.

(4) The client makes a valuation of his loose plant at the Balance Sheet date.

A working sheet, similar to the one set out on page 78 (No. 5), is prepared each year and no great difficulty is experienced in completing the accounts and giving a report that the accountant is satisfied with their accuracy.

#### **(e) Solicitor**

*E* is a solicitor. A solicitor's accounts constitute a special case because the solicitor is so frequently the temporary custodian of clients' moneys and in the small "one man" practice, if records are allowed to fall into arrear through pressure of business, or are not reasonably complete, confusion of moneys is almost inevitable; an accountant may be called upon to evolve order from something approaching chaos.

The Solicitors Act of 1933, together with the Rules made thereunder by the Law Society, came into force on the 1st January, 1935, and the effect of the Act and Rules must be thoroughly appreciated. Its principle is that moneys coming to the hands of a solicitor in connexion with his practice are to be distinguished as (a) moneys received from

or on account of clients, and (b) moneys received and paid on his own account. This distinction must be maintained throughout the office book-keeping system and in the Banking Accounts.

The Rules impose a statutory duty on the solicitor to keep "such books of account as are necessary to distinguish" these two classes of money, and also to open a Bank Account or Accounts in the title of which the word "client" appears. Moneys received on behalf of clients must be recorded separately in the books and paid "without undue delay" into the "client's" Bank Account. In no case must clients' moneys pass into the solicitor's own account except where the client has for his own convenience requested that a specific amount should be withheld from the client's Bank Account.

The Law Society is given power to take action in order to ascertain whether the Rules are being properly complied with in any particular case, and for this purpose it may call for the production of books, Pass Books and vouchers, and penalties may be imposed in the event of default.

Small solicitors, in many cases, keep a form of Cash Journal which is provided with columns for the entry of cash transactions and Journal rulings for such matters as transfers in respect of charges debited to clients and credited to the Private Ledger Account or for other Private Ledger items.

Such Cash Books must now show clearly (a) cash received and paid on clients' accounts, and (b) cash received and paid on "office" accounts, that is, the solicitor's own account. If the Cash

Book is found not to show this distinction completely, the first step of the accountant will be to go through the transactions and make the separation. Next, he should agree the two (or more) Bank Accounts, "client's" and "office," with the respective columns in the corrected Cash Book and arrange for any adjustments and transfers necessary as between the accounts to be immediately dealt with, ensuring at the same time that such arrangements are made as will cause this distinction to be observed and maintained in the future. The Ledger Accounts of the clients should show, preferably in separate columns, (a) the receipt and payment of moneys on clients' accounts, and (b) charges by and payments to the solicitor for his services and disbursements. If this has not been done in the past, the accountant must make the distinction. To do this it may be necessary to rewrite the accounts but in most cases he will probably be able to deal with past transactions by checking the postings from the Cash Book and ticking items falling under (a) in ink of one colour and under (b) in ink of another colour; when he has done this, he should go through the accounts and abstract separately the balances on (a) and (b) items, carrying down both balances, possibly on opposite sides of the same account, arranging of course for proper treatment in future.

Particulars of charges against clients in respect of costs, disbursements, etc., will usually be available in a "Bills Delivered" Book and, when duly checked and completed, this book will provide the material for the credit to Profit and Loss Account and the debits to the clients' personal accounts.

It is usually advisable, in small cases, to check this throughout to the Ledgers, and there will also be a Petty Cash Book which need not contain any unusual features.

In preparing the financial statements of a solicitor's practice, the Trial Balance should be in two parts—

(1) The list of balances on the clients' Ledger Accounts, representing clients' money in the solicitor's hands, which should be equal to the balance, or balances, on the clients' money Banking Accounts (with the exception referred to below); and

(2) The balance on Office Accounts, which will be all items not included in the list (1).

The exception mentioned is that the solicitor may maintain a balance of his own money in the client's Banking Account for the purpose of covering Bank Charges, etc.; if he does not do so, he must arrange for such charges to be debited against his Office Account.

Consideration should be given to the value of uncompleted work, or work in respect of which no bill has been delivered; in many practices, no value is set upon this work, but if it differs substantially at the beginning and end of a year, the omission may materially affect the profit shown.

In drafting the Balance Sheet of a solicitor, the item "Creditors" should be split so as to show separately—

- (a) Moneys due to clients, and
- (b) Moneys due on other accounts;

and the two Bank Accounts should also be shown



separately in order that the relation between "clients'" creditors and "clients'" Bank Account may be seen.

**(f) Farmer**

The majority of English farms are small in extent and are worked by the farmer personally, usually with the assistance of his family and a small working staff. In such cases the farmer is able to exercise a general supervision over the whole of the operations of the farm and to obtain a view of the result sufficient for his own purposes; consequently, he is frequently lacking in enthusiasm for completeness of accounting record. For taxation purposes, it is accepted that such a farmer is unable to prepare accounts and, in their absence, a conventional basis is provided for the purpose of the assessment of farming profits to income tax, this being based on the arbitrary assumption that the full rental value of the farm is a fair measure of the profits arising from its occupation.

In certain circumstances, however, the farmer may desire to prepare accounts, either for his own information or for taxation purposes.

In practice, the available records will be found to touch all points of the scale from the classic example of the farmer who kept his records on the barn door to the scientific farmer who indulged in intricate costings.

As a general rule, a farmer will at least keep a diary and a labour book. Most farmers also avail themselves of the facilities offered them by the banks. The farmer usually records his transactions

in his diary as they occur, not at worked-out amounts but as a note of quantities and prices, in relation to both purchases and sales. Notes will also be found of payments received and the date of such receipt. As to the labour book, this usually records the wages paid each week and, possibly, cash disbursements. The bank Pass Book will also provide useful data since, in all probability, the larger transactions will have been settled by cheque. Information may also be contained on the counterfoils of the paying-in book and cheque book as to the nature of transactions.

As a rule, most of the corn sales are effected through one or two merchants and purchases of feeding stuffs, seeds and manures are made from these same merchants and a final settlement between the parties is effected by a payment to the party who, as a result of the various set-offs, is in credit at the date of the settlement.

As to the live stock, a register of the movement of cattle, pigs and sheep must be kept by the farmer and this register will be useful in checking the purchases and sales. Auctioneers' accounts will also be available if the farmer is sufficiently methodical to have retained them.

Upon being called upon to prepare the first set of accounts, the accountant should request the farmer to make a detailed valuation of all stock on hand, distinguishing working and other horses, dairy cows and other cattle, sheep, pigs, poultry, etc. Implements and machinery should be separately scheduled and estimates made of the corn on hand, whether in stack or threshed. Details of root crops, hay, straw, manures and tillages must

also be obtained, the latter being valued by reference to the seeds and manure used and labour expended. Information as to the precise acreage of the farm and how it was cropped during the preceding twelve months will afford a useful check on sales. The accounts of merchants and others with whom the farmer has had dealings should be obtained, and schedules of creditors and debtors prepared.

The bank payments for the period after the date of account should be scrutinized for any payments relating to the period of the accounts in respect of liabilities which may not have been picked up elsewhere.

The next procedure is to prepare a statement of affairs based on the information obtained as above.

The Cash Book should next be written up, information as to receipts being obtained from the diary, register of the movements of live stock, auctioneers' statements, merchants' accounts, paying-in slips and the bank Pass Book. Details of payments and the nature thereof will be obtained from the labour book and cheque counterfoils in addition to statements, receipts and the bank Pass Book. Care should be taken to note any additions to implements and machinery made during the year.

Having completed the writing up of the Cash Book, nominal accounts should be opened in a Ledger and the Cash Book items posted. Contra items should be journalized and in this connexion it may be mentioned that the accountant will, in all probability, find that there are no details available as to the proceeds of the sales of butter,

eggs and, where only a few cows are kept, of milk, the reason being that it is customary for the farmer's wife to retain such cash for housekeeping purposes. An estimate of the receipts from this source must be made and brought into credit, the debit, of course, being made to "Drawings" Account.

The next step is to prepare a statement of affairs at the commencement of the period. The debtors and creditors will have become apparent as the various receipts and payments during the year have been vouched, but the difficulty will be in the making of a satisfactory valuation of the live and dead stock. The corn, etc., on hand at the commencement can be ascertained by taking the sales during the year, adding the quantity consumed as feed during the year and valuing at the prices obtaining at the date of the statement of affairs, care being taken to exclude any of the current year's crop. As to the live stock, the number on hand at the end of the year having been ascertained, additions must be made in respect of sales during the year and deductions made in respect of purchases and beasts, etc., bred. The valuation of implements at the commencement will be arrived at by taking the closing valuation, deducting purchases made during the year and adding sales effected. There should also be added such a sum as will represent the current year's depreciation—usually 10 per cent.

Having journalized and posted the various items, a Trial Balance should be drawn and the Trading and Profit and Loss Accounts and Balance Sheet prepared.

If the accountant is instructed to prepare accounts for subsequent years he will, of course, have a starting point in his last Balance Sheet, and he may find that the records are a little more complete, but he will find that most of the work set out needs attention in each year. In general, it will be well not to carry out the work until a little time has elapsed after the end of the period of account, and it will then be possible to list payments made subsequently to the date of account in respect of liabilities at that date and to see that these are brought into account.

### **(g) Back Duty Investigation**

Special circumstances arise in connexion with the preparation of accounts in what are known as "Back Duty" cases, and these almost always call for the preparation of statements from records which are incomplete; not infrequently intentionally incomplete.

Every case presents individual features and it is usually necessary to form a view as to the course of trading over a series of years.

Main reliance will be placed by the Inland Revenue authorities on "A statement of means" or "A means test," that is, a statement of the total financial worth of the individual concerned at a given date several years earlier, taken in comparison with a similar statement at the end of the period under consideration, his cost of living, purchases of investments, repayments of loans and similar relevant factors being brought into account.

The following is a specimen case—

*A* and *B* are partners and have conducted a successful business for fifteen years. Accounts have been prepared annually from the business records and accepted as the basis for income tax assessments; both the partners have small amounts of income from investments outside the business and each owns property.

The business fell on bad times and money was paid in from a Bank Deposit Account hitherto unknown to the accountant who had prepared annually accounts of the trading. Following upon his inquiries, disclosure was made to the Inspector of the fact that proceeds of certain cash sales had been paid to undisclosed Bank Accounts in the names of the partners and that these amounts were not brought to credit on Profit and Loss Account in the years in which they arose.

Investigation is required and agreed, and an accountant instructed to prepare statements covering a period of twelve years.

Disclosure is made of a number of Bank Accounts, some in joint names and other accounts in the name of each of the partners. Also the existence of property and investments previously unknown is disclosed, income in respect of which has been paid into one or other of the undisclosed Deposit Accounts, having been received, of course, subject to deduction of tax.

No records exist in respect of the Cash Sales diverted from the business to private accounts, and the only source of information is the undisclosed Bank Accounts.

(1) The accountant sets up a statement of

“means” as at the beginning of the twelve-year period in respect of each of the partners, setting out all property then possessed.

(2) He examines each private Bank Account and marks off all payments into these accounts which can be traced as having come from the business accounts and been recorded therein as drawings or amounts which represent transfers between accounts.

(3) Summaries in respect of each year of other payments into each of the accounts are made under the heads—

(a) Source untraced, assumed to be cash sales unaccounted for.

(b) Income from assets, investments, properties, etc., taxed at source, and the purchase and sale of assets.

(4) Summaries of withdrawals from the several accounts and, as far as ascertainable, the use of these moneys, are prepared.

(5) A statement of the position of each partner at the end of the twelve-year period for comparison with the statement at the beginning is prepared, and reconciliation between these made by the use of the other statements drafted.

(6) Adjusted statement of income for each year beginning with the agreed assessments of profits returned for taxation, to which are added items under (3) (a) above.

(7) Statements of total income for each year (for super-tax or sur-tax purposes) being the income as stated under No. 6 above, together with income taxed at source 3 (b).

(8) Schedules of (a) Property, showing cost,

amount received if sold, etc., (b) Investments giving detail of all transactions, (c) Rents received in each year, and (d) Dividends and interest received; together with any other similar information will be necessary.

The importance of examining vouchers and other documentary evidence by way of verification in these cases can hardly be overstressed—nothing must be taken for granted. The vouchers must receive careful scrutiny to ensure that the items relate to the person or business under examination and that the goods bought, or charges accepted, are proper and normal to the business.



## CHAPTER VI

### REPORTS TO CLIENTS

THE report of an auditor to the members, made in accordance with the provisions of the Companies Act, can be kept at a minimum because there are certain statutory obligations with which the auditor must comply, and there has been a line of cases defining and interpreting his responsibility. If he has carried out his obligations and obtained satisfaction that the Balance Sheet is a true picture of the facts, he may just say so or report in what respects his sense of satisfaction is qualified.

In the case of the preparation of accounts from partial records, a report should always be made by the accountant to his principals and either the report itself or a reference thereto should be placed upon the face of the Balance Sheet or Statement of Affairs. It will not be a "certificate"; an accountant certifies as to facts or reports an opinion. The conclusion will normally be an opinion that the statements prepared present a true view of the position of the business, or to what qualifications that view is subject, in the accountant's opinion. It has already been mentioned that the possibility of the use of a statement, prepared for one purpose, for a totally different purpose cannot be excluded, but the accountant can guard against inappropriate use, whether deliberate or inadvertent, by an adequate report with due qualifications so placed that any person

to whom the financial statements are exhibited receives notice of the existence of the report.

It is in all cases desirable that the proprietor, or proprietors, should sign a copy of the Statements, in the same manner as Directors are required to sign a copy of the Balance Sheet of a company under the provisions of Section 129 of the Companies Act, 1929.

The report should be so worded as to put any person reading it into a position to appreciate the state of the records available to the accountant, the extent of the work he has done, and the verifications he has received, together with any estimates which enter into the figures, as well as his general satisfaction, or otherwise, with the result, but, on the other hand, care is necessary that the report should not be overloaded with detail; technical terms should be avoided, and a style, direct, simple and free from ambiguity should be cultivated. The personality of the reader should be kept in mind during the drafting.

### **Specimen Reports**

A simple report placed on a Balance Sheet in respect of accounts prepared from a Pass Book, together with vouchers sufficient to satisfy the accountant that the payments made are proper to the business and were, in fact, made out of the funds of the business under examination, might read—

We have prepared the foregoing statements from the Bank Pass Book of the business, together with vouchers produced to us and, in our opinion, the above Balance Sheet (or Statement of Affairs) is properly drawn up so as to exhibit a true and correct view of the state of affairs according to the best of our information and the explanations given to us.

A somewhat fuller report would follow the company form and say—

We have examined the accounts of . . . for the year ended . . . We have prepared the foregoing accounts and Balance Sheet from the books and vouchers of the business and have obtained all the information and explanations we have required. In our opinion, this Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the affairs of . . . according to the best of our information and the explanations given to us and as shown by the books.

A statement on the face of a Balance Sheet which is accompanied by a detailed report, might be—

We have prepared the foregoing Balance Sheet from the Bank Pass Books of the business, as supplemented by information supplied to us, and have this day made the accompanying report thereon.

### **Nature of Report**

In drafting the report, the accountant will have in mind the purpose for which his accounts have been prepared and, therefore, the nature of the report which would be desirable; and from an early stage in the investigation, he will have planned his work so as to reach that position, if possible. This very fact, however, emphasizes the importance of preserving an open mind until the work is completed, lest the possible interest of the client should be allowed to colour the report.

In general, it may be said that the report, when taken together with the accounts prepared, should indicate (1) the instructions received and the scope of the work carried out, including a sufficient indication of the books and other records examined, (2) the extent to which vouchers have been available and examined, (3) any special apportionments

as between capital and revenue, or as between the proprietor personally and the business, as for example, when the proprietor lives on the premises and rents and rates are apportioned, (4) the extent to which estimates have been used, and who has been responsible for them, (5) a statement as to the responsibility for stock, both as to enumeration and as to valuation, (6) special matters, as for example, in relation to Partnership Accounts.

In conclusion, it should be remarked that it is particularly important in the type of case which has been under consideration that the accountant should call his client's attention to any lessons to be drawn from the accounts prepared. In small cases, especially, the client is often unable to draw these lessons for himself from the statement of figures, and will appreciate the action of the accountant in the matter. For example, if the accountant has been engaged in the matter for several years, he will be able to say whether the ratio of gross profit is being maintained, whether the burden of specific overhead charges relative to the turnover is increasing or decreasing and, in general, to call attention to any particular items of expense which appear to him to need the client's consideration.

## CHAPTER VII

### ON COMPLETING ACCOUNTS FOR THE FUTURE

THE accountant will naturally endeavour to arrange for the maintenance of such records in future as shall enable him to prepare complete and reliable accounts with a minimum of difficulty and uncertainty. He will consider the methods of the business and the personnel available, with a view to drafting a system in the simplest form possible. He should be able to draft a system of book-keeping, so simple and clearly expressed, that persons unfamiliar with business books can understand it and make the necessary entries. The following suggestions are made—

(1) Where a retail business is not only directly supervised by the proprietor but much of the work is done by him, it is obvious that if records are to be kept at all he will, in most cases, have to do it himself and the work involved in any proposed system must be reduced to a minimum. It is suggested that in such a case, if accounts on a cash basis can be maintained accurately and kept written closely up to date, it will be sufficient, and that the keeping of a single book, on the lines set out on page 80 (No. 7), will meet the absolute necessities of the case. It will be seen that the form suggested provides for the cash transactions of each week to be set out on a single page on the following lines—

(a) The entry each day of the total cash takings for the day and of the amounts banked, as and when banked, balanced by a total of cash "spent" as detailed below, and an amount carried forward.

(b) A record of the payments made out of cash, the total of which is carried into the first section.

(c) A list of payments by cheque, divided so as to show separately payments for goods purchased for resale and other cheques—if the client merely completes the outer column the accountant will be able to make the dissection.

A rather more complete form is given at page 81 (No. 8), which may be preferred; in this case the totals under the various heads will be carried to a summary either week by week as they arise, the total being built up for the year, which is the better method, or alternatively, left for the accountant to summarize at the end of the year.

When the accountant, at the end of the year of account, sets out to prepare accounts from the information so available, he will examine vouchers to the extent he considers necessary to verify the entries and allocations made in the book. He will examine till sheets or other evidence in confirmation of "cash takings" as necessary and available. He will check the bank entries with the Pass Book and prepare a reconciliation statement on the Bank Account. He will make inquiry in respect of outstanding accounts due to, or payable by, the business as at the closing date and particulars of the enumeration and valuation of stock-in-trade will be obtained from the proprietor. Having these statements before him, and having also available the statement of affairs prepared at the

end of the last business year, he will have no difficulty in completing his work and drafting a Trading and Profit and Loss Account, together with a Balance Sheet as at the end of the period.

If he is instructed to audit as well as to complete accounts, he will go as much further into the checking and verifications as he considers necessary.

It will be found that in ordinary cases, a single book kept in the form suggested will be sufficient and it will be within the capacity of the client. In cases where some amount of credit is given, a simple form of Debtors Ledger, possibly on a memorandum basis, will be maintained, the payments by the debtors being brought into the main book as received; the accuracy of the Debtors Ledger record being confirmed by the preparation of a total account at balancing time.

(2) On the basis of paying all cash collections into the bank and making all payments either by cheque or through petty cash kept on the imprest system, it will be possible to arrange for a more adequate system of record for a retail trader in cases where more book-keeping knowledge or capacity is available, or perhaps where more interest is taken by the proprietor in this side of his work.

An analysed Cash Book, in the form set out on page 82 (No. 9), which provides columns on the Receipts side for discounts, cash sales, Sales Ledger Accounts (if necessary) and bank, and on the Payments side for discounts and amounts drawn from bank, with an analysis of the bank column for purchases and sundry expense items as may be necessary in each case by way of extension in further cash columns, will enable a

record to be maintained which will suffice for ordinary purposes. It is thought that the form given on the page named is sufficiently explicit and needs no further explanation. If the extension into appropriate columns is not currently made there will be no difficulty in completing it later, or the accountant can do it when vouching.

Any purchases on Capital Account should be extended into the column headed "Sundries" and at the end of each month, or longer period, this column can be analysed as necessary.

If, as is the unfortunate habit of many small shopkeepers, there are payments out of cash, it will be necessary to have a cash column on each side and the cash items on the payments side will be extended into the appropriate analysis columns.

The two bank columns will, of course, show the balance for reconciliation with the Pass Book.

In addition, a Sales Day Book for credit sales, the total of which will be posted to a Sales Account, and the detail to the individual debtor's accounts, will also be necessary, and a Debtors Ledger, postings to which will be from the Sales Day Book and the Cash Book.

It is suggested that a Private Ledger should be kept in all but the smallest cases, but in its absence similar record can be maintained in the accountant's papers or working sheets.

At balancing date, care must be taken to bring in all outstanding accounts, whether for goods for resale, or for accrued charges in respect of such expenses as rates, heating and lighting, etc., and the unexpired values of insurance premiums paid, if these justify such treatment.





## APPENDIX

	PAGE
(1) TOTAL BANK ACCOUNT . . . . .	75
(2) TOTAL CASH ACCOUNT. . . . .	76
(3) JOURNAL . . . . .	77
(4) CAPITAL ACCOUNT . . . . .	77
(5) WORKING SHEET . . . . .	78
(6) TRADING AND PROFIT AND LOSS ACCOUNT AND BALANCE SHEET . . . . .	79
(6A) ALTERNATIVE STATEMENT OF RESULT . . . . .	80
(7) FORM: CASH RECORD . . . . .	80
(8) FORM: CASH RECORD . . . . .	81
(9) ANALYSED CASH BOOK . . . . .	82



(1)

## BANK ACCOUNT—SUMMARY FOR THE YEAR

Dr.		£	£	1936 Dec. 31		Cr.
1936 Jan. 1	To Balance b/f . . .		£ 120		By Creditors (Purchases) . .	£ 8200
	" Cash (Contra) . . .	9000			" Cash Purchases . .	200
	" Debtors (Sales) . . .	1000			" Wages . .	500
Dec. 31			10,000		" Salaries . .	300
"					" Rent and Rates . .	150
					" Light and Heat . .	60
					" Stationery and Printing . .	30
					" Telephone and Telegrams . .	55
					" Insurance—	
					Fire . .	25
					Employers' Liabilities . .	5
					Accident . .	10
					Drawings . .	385
					Repairs and Replacements . .	38
					Sundries . .	100
					Balance c/d . .	10,058
						62
1937 Jan. 1	To Balance b/f . . .		£ 10,120			£ 10,120
			62			



# CONSTRUCTING ACCOUNTS

77

## (3) JOURNAL

31st December, 1936

	£	£
Sales . . . . . Dr.	45	
To Purchases . . . . .		45
Being transfer of amounts settled in Contra, as per list.		
Purchases . . . . . Dr.	350	
To Creditors . . . . .		350
Being amounts outstanding at this date, as per list.		
Debtors . . . . . Dr.	800	
To Sales . . . . .		800
Being amounts outstanding at this date, as per list.		
Wages . . . . . Dr.	10	
Rent . . . . .	7	
Printing and Stationery . . . . .	10	
To Insurances . . . . .		12
„ Suspense Account . . . . .		15
Being amounts accrued due and unexpired values at this date		
	<u>£1,222</u>	<u>£1,222</u>

## (4) CAPITAL

T. Brown

	£	£
Balance at 1st Jan., 1936 . . . . .		670
Payments made:		
National Furniture Co. . . . .	64	
Dr. A. S. . . . .	42	
Brough, Jenkins & Co. . . . .	25	
X. Y. . . . .	26	
Rent (Personal) . . . . .	65	
Cash cheques . . . . .	163	
	<u>385</u>	
Cash Drawings . . . . .	147	
		532
		<u>£138</u>
Add: Profit for the year . . . . .		824
		<u>£962</u>
Balance, 31/12/36 . . . . .		

(5)

## WORKING SHEET FOR THE YEAR ENDED 31ST DEC., 1936

T. Brown, Brohampton

(Note. For simplicity shillings and pence have been omitted from this example.)

	Balance Account 1st Jan., 1936		Bank Account Summary		Cash Account Summary		Adjustments— Journal		Profit and Loss Account for the year		Balance Account 31st Dec., 1936	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Stock: 31/12/1935 . . . . .	£	£	£	£	£	£	£	£	£	£	£	£
Purchases 31/12/1936 . . . . .	400		8,400		850		350	45	400	450	450	
Creditors for purchases . . . . .		400						350	9,555	400		
Sales . . . . .				1,000		10,150	45	800		11,905	800	350
Debtors for sales . . . . .	505						10		505			
Wages . . . . .	5		500						515			
(Mrs. Brown) . . . . .									52			
Salaries . . . . .			300		50				350			
Rent and Rates . . . . .		2	150				7		155			
Light and Heat . . . . .		10	60		8		10		68			
Stationery and Printing . . . . .		5	30						25			
Postages and Telegrams . . . . .		5	35		10				60			
Insurance . . . . .			40						43			
Charities . . . . .	15				5			12				
Subscriptions (Trade and Hospital)					3				5			
Repairs and Replacements . . . . .			38		12				3			
Summies (per detailed schedule)			100		45				50			
Balance—Carried to Capital a/c . . . . .									145			
									824			
									£12,755	£12,755		
Bank . . . . .	120		10,000	10,058	10,150	10,182				62	62	
Cash . . . . .	47			9,000	9,000					15	15	
Centre . . . . .												
Suspense Accounts—Appointments								15			12	27
Capital a/c—T.B. . . . .		670	385	£20,058	£20,332	£20,332	£1,222	£1,222	824		£1,339	£1,339
	£1,092	£1,092	£20,058	£20,058	£20,332	£20,332	£1,222	£1,222				27
												962
												£1,339

(6)

*T. Brown*

## TRADING AND PROFIT AND LOSS ACCOUNT

for the year ended 31st December, 1936

<i>Dr.</i>			<i>Cr.</i>
To Stock at 31st Dec., 1935 . . . . .	£ 400	By Sales . . . . .	£ 11,400
„ Purchases . . . . .	9,155	„ Stock at 31st Dec., 1936 . . . . .	450
„ Wages . . . . .	567		
„ Balance c/d . . . . .	1,728		
	<u>£11,850</u>		<u>£11,850</u>
To Salaries . . . . .	350	By Balance b/d . . . . .	1,728
„ Rent and Rates . . . . .	155		
„ Lighting and Heat . . . . .	68		
„ Repairs and Replacements . . . . .	50		
„ Printing and Stationery . . . . .	25		
„ Postages and Telephones . . . . .	60		
„ Insurances . . . . .	43		
„ Subscriptions and Charities . . . . .	8		
„ Sundry Expenses . . . . .	145		
„ Balance, transferred to Capital Account . . . . .	824		
	<u>£1,728</u>		<u>£1,728</u>

*T. Brown*

## BALANCE SHEET AS AT 31st DECEMBER, 1936

<i>Liabilities</i>		<i>Assets</i>	
Creditors . . . . .	£ 350	— Bank Ltd. . . . .	£ 62
Accrued Charges . . . . .	27	Cash . . . . .	15
Capital—		Debtors . . . . .	800
<i>T. Brown. As at 31 Dec., 1935 . . . . .</i>	670	Stock in Trade . . . . .	450
<i>Add Profit for the year . . . . .</i>	824	Unexpired Values . . . . .	12
	<u>£1,494</u>	Fixtures, fittings and furniture written off . . . . .	—
<i>Less Drawings . . . . .</i>	532		
	<u>962</u>		
	<u>£1,339</u>		<u>£1,339</u>



## CONSTRUCTING ACCOUNTS

(6a)

### ALTERNATIVE STATEMENT OF RESULT

Sales for the year ended 31st December, 1936 . . . . .	£	11,400
Less Cost of Sales: Goods . . . . .	£9,105	
Wages . . . . .	567	
	<u>9,672</u>	
Gross Profit . . . . .	£1,728	
Less Establishment Charges (in detail) . . . . .	904	
LEAVING NETT PROFIT . . . . .	<u>£824</u>	

(7)

## SMALL RETAIL BUSINESS

**(Sales for Cash only)**

### Weekly Cash Record

19...		£	19...		£
Jan. 1	Takings	12	Jan. 3	Banked	30
2	"	8			
3	"	13			
4	"	7			
5	"	15	5	"	20
6	"	25		Spent as below	20
	Total	£80			£70
Brought forward from last			Carried forward to next		
week		25	week		35
		<u>£105</u>			<u>£105</u>

### Cash Payments

### Detail Items as paid out

### Wages as paid out

**Total, As above . . . £20**

**BANK PAYMENTS (by cheque)**[illegible]

## WEEKLY SUMMARY FOR SMALL RETAIL BUSINESS

**Sales entirely or mainly for cash**

**Week ending** ..... **19** .....

<i>Daily Cash Takings</i>			<i>Bankings</i>		
Monday . . .					
Tuesday . . .					
Wednesday . . .					
Thursday . . .					
Friday . . .					
Saturday . . .					

[illegible]

(9)

(Additional columns, as necessary, for Carriage, Rent, Rates, etc., Light and Heat, Petty Cash, Drawings, etc.)

Cr.

# INDEX

ACCOUNTANT's responsibility, 11-14

Accounts, building up, 27-30

Auditing, 2, 70

Auditor and Accountant, Distinction, 2

Back duty investigations, 60-3

Bakery comparisons, 28-9

Balance Account, 24, 78

— Sheet, 25, 40, 41, 55, 79

Bank Account (Total), 22, 75

— Accounts, Private, 18, 62

Bankruptcy Act, Section 158, 6-7

— — —, Section 26, 7

Bills Receivable, 40

Builders' accounts, 50

CAPITAL account, 77

Capital expenditure, 39

Cash Account (Total), 23, 76

— basis accounting, 21-22, 33, 49, 68

— books, form of, 69, 70, 82

— record (weekly), 80, 81

— takings, 69

Client's Account (Solicitors'), 53

Company's Act (1929), Section 122, 9

— — —, Section 274, 10

Comparisons, 27-8, 28-9

Contingent liabilities, 41

Costings, 27

Creditors ledger analysis, 26

DEBTORS Ledger analysis, 26

Deficiency defined, 2

Deliberate deficiency, 17, 60-3

Depreciation, 37

Drawings, 23, 38, 59

ENGINEERING shop, 42

Estimates, 27, 37

Examples—

Back duty, 60

Builder, 50

Engineer, 42

Farmer, 56

Shopkeeper, 49

Examples (*contd.*)—

Solicitor, 52

Tailor, 47

FARMERS' Accounts, 56-60

— sales, 57

— working records, 56-7

Financial statements, form of, 32

Forward contracts, 36-7

GROSS Profit—rates, 28-30

*Hawthornethwaite & Sons v. Kelly*, 6

ILLUSTRATIONS of method, 42-63

Investigations, 17-19

Income tax, back duty, 61-3

— — — returns, 1, 46

Instructions to accountant, 12, 30

JOURNALIZATION, 24, 59, 77

LEASE—Amortization, 37

Ledger analysis, 25, 44, 48

Legal provisions, 1-11

Lessons from accounts, 67

Listing books produced, 19

Live Stock Register, 57

MEANS test, 60

Methods, 19-20

*Mutton, In re*, 11

PARTNERSHIP Act, Section 24, 8

— — —, Section 28, 9

— bookkeeping, 9, 38-9

"Pass Book" Accounts, 65

*Pendleburys Ltd. v. Ellis, Green & Co.*, 19

Private Bank Accounts, 18, 62

— Ledgers, 22, 48, 71

Procedure, 15-32

Profit and Loss Accounts, 24, 27, 54, 78, 79, 80

Programme of work, 30-1

"Proper" books, 11

Purpose, importance of, 11-14, 66

Purchases, 3, 25, 33, 43, 47, 51

QUERIES, 26

REPORTS, Staff, 31-2

— to clients, 4, 12, 14, 64-7

Responsibility to keep accounts—

company, 9-10

partners, 9

sole trader, 5-8

Responsibility of accountant,  
11-14

Retail shopkeepers, 3, 49, 68-71

SALES, 3, 18, 25, 33, 36, 42, 59

*Schulze v. Bensted* (1915), 6

Signatures (clients) to accounts, 65

Solicitors Act and Rules, 52-3

— Bookkeeping, 54

— Cash Journal, 53

— "Clients'" Accounts, 53, 54

Statement of Affairs, 24, 40, 41, 45,  
59

Stocks, 34-5, 43, 57, 59

TAILORS' Accounts, 47-8

Total Accounts, 20-5

Trading and Profit and Loss Ac-  
counts, 5, 24, 27, 29-30, 32,  
43, 59, 70, 79, 80

VERIFICATION of Balance Sheet, 3,  
40

Vouchers, 63, 69

WAGES, 35

Weekly Cash Records, 80-1

*Westminster Road Construction*  
case, 35

Working Sheet, 23, 46, 52, 78

Work in Progress, 35





